

STATEMENT OF PRINCIPLES TO RESCUE THE ECONOMY AND RESTORE STABILITY



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BY SENATOR HILLARY RODHAM CLINTON

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The proposal presented by the Treasury Department to Congress over the weekend represents only one component of the steps that need to be taken to address the crisis facing our financial markets, the most severe economic challenge to confront the United States since the Great Depression. While the necessity to intervene in the markets is clear, I have made equally clear that this unprecedented action cannot simply be a blank check that subsidizes the banks and financial institutions' return to profitability while there is no relief for the millions of families still on the hook for the toxic mortgages that are overwhelming them with escalating payments, skyrocketing rates, and negative equity. Not only is this fundamentally inequitable, it wholly ignores the drag that the millions of foreclosures, the hundreds of billions in lost housing wealth, and the ongoing threat of foreclosure have had on our economy. What's more, it may undermine the stability of the very firms this measure seeks to prop up. Simply transferring \$700 billion in risk from the private markets to taxpayers may save our markets today, but it will not strengthen our economy tomorrow or in the long term. For all of these reasons, the proposal Congress will consider this week should only be the first step in stabilizing our economy, not the last.

While stabilizing the marketplace must be a priority, the stabilization of our homeowners, businesses, and communities, is no less important. They too have been thrown into upheaval as a result of the self-sustaining cycle of falling home prices, negative equity, default, and foreclosure, which continues to wreak havoc throughout the nation. The Wall Street employees of the financial sector I represent have been devastated by the market upheaval, but the workers and families I represent in Upstate New York and Long Island deserve relief as well.

Moreover, the extraordinary authority granted to the Secretary of the Treasury to administer the proposed bailout program requires that more explicit taxpayer protections be included. We must do everything we can to ensure that the extraordinary taxpayer investment made in this program will be effective and responsible.

Upon my initial review of the Treasury's proposal, I believe that Congress must work to ensure that the following principles are addressed. They should be advanced with the same urgency that has been given to the market stabilization proposal. This cannot simply be a market rescue. It needs to be an economic rescue.

I. **Principle #1: Immediately Move to Create a New Federal Initiative to Commence a Massive Mortgage Refinancing Effort and Aggressively Pursue Mortgage Modifications to Halt the Foreclosure Crisis**

There must be a significant component of this plan that addresses the millions of homeowners drowning in the trillions of dollars in outstanding mortgage debt. With 2.7 million homeowners holding over \$1.3 trillion in Adjustable Rate Mortgages (ARMs) scheduled to reset upward, and 2 million homeowners plagued by negative equity in their homes and \$3 trillion in

outstanding mortgage debt, foreclosures will continue to be a huge anchor on our economy and our markets if left unaddressed.

For well over a year, I have been calling for the workouts and modifications of the unworkable mortgage terms that have been the impetus for the crisis we face. **In my estimation, mortgage modification must be a central component of any proposal and it should be the immediate next step for Congress.** Moreover, this initiative should be at least proportional to the intervention for the banks. Congress must explore the creation of a new federal entity or in the alternative, give the Treasury Department or FHA the mandate and resources to begin this critical undertaking in order to make mortgage modification effective.

Congress should begin the immediate consideration of legislation that will leverage the bargaining power and reach of the federal government and create a new entity or empower an existing agency to begin the large mortgage modification efforts that are necessary to prevent further disaster.

This model works. During the Great Depression President Roosevelt created the Home Owners' Loan Corporation (HOLC), which bought out and took over the mortgages of the failed banks and modified their terms so that families could stay in their homes. This critical program saved 1 million homes and even returned a profit to the Treasury when it finally closed its books. Today, the FDIC has already begun a modification program for the mortgages held by the defunct bank Indy Mac. There is no reason why we cannot move to take this initiative to a larger scale and ensure fewer foreclosures and less devastation to home values. At today's homeownership rates, a modern day HOLC could save rough 3 times as many homes if it matched the Depression era HOLC's success.

With a crisis that has already been compared to the Great Depression in its significance, the sheer scale of the potential disaster that lies ahead demands strong and swift action. I called for the creation of a modern day HOLC last spring, and I believe that model could complement the Treasury's plan to offer homeowner relief in addition to the market relief.

In the meantime while the Treasury holds the notes on these toxic mortgage securities, the Secretary should take steps to identify which of the underlying mortgages can be salvaged through a modification of mortgage terms or a refinancing into a safer and more stable loan. The companies offloading their debt on the Treasury should share relevant data that would make identifying the troubled mortgages easier. In addition to helping place a value on the security, the Treasury could then turn to the new HOLC, which in turn could then open these securities and initiate outreach to the troubled homeowners who would benefit from a modification and immediately begin to negotiate new and fairer terms.

The HOLC could also conduct large scale refinancings for all of the mortgages within the security if that proves to be more efficient. This can be done in a manner that protects the economic interests of all parties involved while mitigating the outstanding legal and contractual obligations that have hindered mortgage modifications thus far. Until this new entity or initiative is launched and ready to take over, the government should immediately move to empower the FDIC and the FHA to begin these mortgage modifications. The scale of the current problem requires a stable and independent program that can move swiftly and effectively.

Setting the Standard for Fair, Stable and Balanced Mortgages – Many have called for the use of this opportunity to change the dynamic of the mortgage market and to move away from the adjustable rate and hybrid mortgages that concealed liabilities until it was too late. We need to demonstrate to the marketplace that giving people a fair shake and telling them upfront what their obligations are and allowing them the flexibility to keep current on their payments and stay in their homes is linked to long-term prosperity and is the best way to keep the markets stable. The HOLC could redefine the standard for what a safe mortgage is through the creation of a mortgage that has de-facto modification terms already included. Simply put, the HOLC could guarantee a fixed monthly payment that didn't change or skyrocket, ensuring that a homeowner knows exactly what their monthly liability is. And if there is a disruption – such as a lost job or medical emergency that made a payment difficult – the terms of the mortgage could automatically kick in a lower monthly payment and simply extend the length of the mortgage. In most instances there would be no need for further refinancing if there is flexibility in the payment structure to account for emergencies or unforeseen events. Subsequently, if a homeowner had the ability to pay down the principle early or wanted to utilize a raise or an inheritance or other source of cash, they could make larger payments for a period of time and pay down the principle with no pre-payment penalty. This is what enabled the HOLC to save so many homes during the Great Depression and is precisely what a HOLC could do for us today.

Indeed, the old economic arguments that opposed such an intervention of this scale are now moot in light of the unprecedented market rescue announced this weekend. If our financial institutions can be stabilized, so should the American homeowner.

All of the tools at the government's disposal should be utilized effectively to rewrite the mortgages that are the ticking time bomb that could trigger the next crisis.

Other worthy options also exist. Encouraging more refinancings through the new FHA Hope for Homeowners program is one, as is requiring or encouraging more participation in the program by lenders helped through the Treasury program through more outreach and better terms for lenders.

Bankruptcy Reform – Another avenue worth examination by Congress is smart bankruptcy reform legislation that would allow bankruptcy judges the opportunity to adjust the terms of some mortgage loans as part of bankruptcy proceedings. Permitting this form of modification in certain cases would also help troubled borrowers avoid foreclosure.

Temporary Moratorium on Foreclosures – For too long the financial and investment industries opposed and dismissed my calls for a temporary halt to the foreclosures that were driving our economy ever closer to crisis. A short moratorium on foreclosures would have allowed many distressed homeowners to work with their lenders, refinance into better loans, and allowed the banks and other lenders to assess what could be done to keep people in their homes and protect their bottom line. Now that the bottom has fallen out, the taxpayers have given corporate America a moratorium on financial institution failures. In exchange, the financial institutions, the government, or whoever holds the notes on the troubled mortgages, should give worthy but troubled homeowners a temporary moratorium on foreclosures. Such a move would create breathing room to enable us to assess our future risk and take steps now to prevent falling back into crisis.

The old economic arguments that a foreclosure moratorium would hinder bank capitalization should be dismissed. The government's unprecedented move to remove \$700 billion in toxic debt off the books basically amounts to the biggest capitalization incentive in our nation's history.

Temporary Freeze on Unreasonable Adjustable Rates Increases in Mortgages— The adjustable interest rates tied to so many of the subprime mortgages deepened the housing crisis and resulted in millions of homeowners facing sudden, skyrocketing monthly payments. While rising rates wreaked havoc in subprime, a whole new class of mortgages including “Alt A” and “hybrid ARMS” held by more than 2.7 million Americans are set to reset over the course of the next few years which will grow the \$1.3 trillion in outstanding debt in these mortgages, threatening to unravel any stability gained through the Treasury's actions. A temporary freeze in the interest rates while requiring homeowners to work with lenders to seek better and more stable mortgage terms could help prevent another looming disaster.

Secretary Paulson has said that we need “decisive action to fundamentally and comprehensively address the root cause of our financial system's stresses”. The current proposal's lack of any requirement for mortgage modification or foreclosure mitigation undermines the Secretary's stated goal.

Aggressively Utilize the FHA Refinancing Initiative – The Frank-Dodd legislation passed this summer included many of the FHA reforms that I began calling for over two years ago. We must employ the FHA refinancing initiative provided for in this important legislation. A strong FHA could be an effective way for troubled homeowners to refinance into a stable FHA mortgage.

But adequate resources are needed to help the FHA aggressively court lenders and borrowers and make refinancing a more sensible option for both the borrower and the lender. This initiative was applauded by the President, but the FHA cannot be another proposal that is touted by the Administration but then abandoned or perverted in purpose after the cameras are off.

II. Principle #2. Real Accountability and Oversight of the Financial Institutions Being Rescued and Real Protections for the Taxpayers

The American people are being asked to put forward nearly three quarters of a trillion dollars to save the U.S. financial system, and as such, they should receive a return on their investment in the form of a new corporate ethic that rewards responsibility, transparency and accountability and a share in the return to profitability.

Curb Exorbitant CEO and Executive Pay – First, outrageous compensation structures helped fuel the frenzied hunt for short-term profit but jeopardized the long-term health of the companies involved, the markets, and the very soundness of the U.S. economy. They must be reformed. Companies that benefit from the new initiative should ensure that their executives' compensations are tied to long-term performance and solid economic growth, not short-term stock performance driven by hidden losses and irresponsible lending and borrowing. They should be accountable to their shareholders as well as the American people, who now pay their salaries. The tax shelters and unethical practices employed to shield compensation structures and loopholes that have been exploited for too long must be stopped. Moreover, balance should be restored to the inequitable

tax structure that allows the biggest billionaires on Wall Street to pay a lower tax rate than their secretaries and millions of other middle class working families.

Responsible Financial Institutions – If the taxpayers must take on the burden of bad assets, companies should not be given free rein to use this debt forgiveness simply as an opportunity to increase their dividends or bump up their executive bonuses. Regardless of their earnings, reports, or what their balance sheets said, it was evident that our financial institutions were too leveraged and too exposed to risk to be sound. Sound risk management principles should be mandated for the institutions rescued by the bailout program. This could be achieved through higher capital reserve requirements, a fee for insurance against financial disaster, and unwinding their exposure to counter party risk.

Taxpayers' Return on Their Investment – As companies push the worst debt off of their books and onto the taxpayers' backs, the taxpayers should see some return for the risks that they are assuming. The current proposal allows for the assumption of enough of any company's given debt that it would effectively make the government and the taxpayers their majority shareholders. Like any other shareholder, the taxpayer should be entitled to a share of the gains if profitability returns. As a general principle, the bailout proposal should include provisions that would require the Treasury to implement a meaningful "shared equity" model, one that for example provides for the issuance of warrants in shares based on the amount of bad debt taken on by the government in any given company. Such a modest return structure rewards taxpayers for the unprecedented risk they have assumed and gives them a stake in the performance of the company and our financial sector. Such a provision could be crafted so as not to discourage or disincentivize a company's participation in the program nor thwart our financial sector's return to health.

Ongoing Financial System Reform - Going forward, as companies emerge from the wake of this crisis with the help of the American people, they must give our citizens a reason to renew their trust and confidence in the financial system. What this mess has revealed is that huge financial institutions are so entwined with other institutions that their failure could easily set off a fire that would sweep through the entire market system. The Secretary should mandate a commitment from these rescued institutions to prioritize the well-being of the American people through minimizing their risk by curbing their addiction to the extremely risky derivatives, special investment vehicles, and other securities products like the credit default swaps and collateralized debt obligations that obscured the actual risk as well as any semblance of accountability when investments started to fail.

The financial institutions should also make a commitment to the goal of investing in and making available safe and stable mortgages that are based on sound underwriting, accounting and lending practices. The mortgage model put forward by the HOLC, with fixed rates and flexible payment terms that benefit the homeowners, has the potential for changing the entire mortgage dynamic and will allow the marketplace to weed out the complicated mortgages that trapped millions of Americans in default and foreclosure. The American people's confidence in their biggest investments – their homes – would be renewed and everyone would benefit.

III. Principle #3. Ensuring the Accountability and Sound Practices of the New Treasury Initiative

While bestowing sweeping authority on the Treasury Secretary, the proposal as currently written relies on the very people that devised, fueled, invested in, and touted the complex

investment structures, derivatives, special investment vehicles, and other securities that created the current crisis. Indeed, practical expertise and institutional knowledge of the markets is needed to help the government guide this initiative to success. However, if the American people are going to have confidence in this new mechanism, they must know who pulls its levers.

Full Transparency and Real Oversight – We need to know who is working for this initiative and which companies will be working in tandem with the Treasury. Apparent conflicts of interest may be unavoidable, but a full and public disclosure of those conflicts will keep all of those who operate within this effort honest and accountable to the taxpayers. The agents of the Treasury program cannot be put in a position where they effectively sell their own debt to the Treasury while buying the same debt at a price they themselves have set. Transparency is critical and any and all of these situations should be disclosed.

Full Accountability – While responding quickly and nimbly to all of the current troubles is critical to the effectiveness of this initiative, there is virtually no Congressional oversight in the current proposal. If the American people are to be confident in the program's execution and mission – and feel certain that their \$700 billion investment is going to good use – Congress must be kept informed of the initiative's current events and operations and be able to respond to developments as necessary. In addition to requiring eventual Senate confirmation for the head officers of this program, periodic and regular reporting requirements must also be mandated in order to ensure proper oversight. The Treasury Inspector General should also be empowered with audit powers over this new department's activities so that independent oversight is guaranteed.

Accurate Valuation of the Debt Being Bought by the Government – The American people deserve to know the full extent of their liabilities and the Treasury Department has the duty to ensure that they know the full extent of they are burdening taxpayers with. For this reason, the program must also mandate independent verification of the valuation of the mortgage securities being bought based on sound and transparent accounting practices. A structured auction or reverse auction process should be developed to gauge an accurate value of the various securities the government assumes. At a minimum, real time disclosure of the assets purchased by the Treasury and the prices paid would allow the oversight officers, Congress, and the marketplace to determine the appropriateness of the sales. An inaccurate picture of the value of these mortgage securities helped create the confusion, panic, and chaos that engulfed the markets. Simply taking on the liability with no regard for the value of these securities will only invite more disaster. Overpaying for these securities will essentially give the financial institutions a windfall profit funded by taxpayers. In the alternative, paying too little will guarantee that the program is ineffective.

Fiscal Responsibility – Financing the plan will require staggering borrowing, virtually guaranteeing systemic budget deficits and growing debt for the foreseeable future. Proceeds realized through this initiative must be used towards reducing this debt.